

February 16, 2022

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Municipal Water District

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OTHER
REPRESENTATIVE

County of San Diego

VIA EMAIL

Mr. Adam Wilson, Moderator
San Diego County LAFCO
(adwilson858@yahoo.com)

Re: Response to 2/16/2022 Rainbow/Fallbrook Claims to Ad Hoc Committee

Dear Mr. Wilson:

This letter serves as a response by the Water Authority to the two letters sent to you today by counsel for Rainbow and Fallbrook, and by Rainbow and Fallbrook themselves. We ask that you share it with the Commissioners, and the Ad Hoc Committee members.

Before getting into the substance of the response, we note that though Rainbow and Fallbrook continuously complain about the time these proceedings are taking, it does not help to expedite matters by launching attacks on LAFCO and Dr. Hanemann the day before a meeting, nor restating arguments that have already been made and addressed.

1. Letter from Attorneys

The letter from Rainbow/Fallbrook counsel consists of two main elements: an argument against Dr. Hanemann's report as being "disassociated from legal reality," coupled with a request that the Committee and the Commission be reminded that Dr. Hanemann's report is not a legal analysis; and a request that LAFCO address a number of legal issues.

We find these contentions fundamentally unnecessary. Dr. Hanemann's report states on the third page that, "I was not engaged to conduct legal analysis or offer legal advice on the issues I addressed, and I do not offer any legal opinions." No one has ever contended that Dr. Hanemann was performing any sort of legal analysis. Rather, he was doing a *factual* analysis, one that was necessary to assist LAFCO Commissioners and staff, and the Committee, in their review. It is therefore counterproductive to continue to badger LAFCO and Dr. Hanemann with assertions such as stating that his report is "not founded or based on the County Water Authority Act," and similar statements.

Second, counsel for Rainbow and Fallbrook ask that LAFCO's staff and its counsel address a number of legal questions before making their ultimate determination. We have often stated to LAFCO that there are a host of legal questions that must be addressed before any final decisions are made. Indeed, we spent 33 pages (pp.152-185) of our September 2020 Response going into these legal issues in great depth. It is

noteworthy, however, that Rainbow and Fallbrook's counsel demand that LAFCO engage in a detailed legal review, without *Fallbrook and Rainbow yet having done so*. Our detailed legal analysis in the Response has not yet been addressed in any specificity by those promoting detachment. Rather than demanding that LAFCO generate their legal research for them, Rainbow and Fallbrook should first submit detailed legal briefing in response to our Response submittal. Once LAFCO has all the legal arguments before it, then at that time it might be prudent for LAFCO and its counsel to invite counsel for the parties to come in and argue their points, and answer questions from LAFCO and its counsel. That is not yet ripe until Rainbow and Fallbrook actually go on the record with all their legal arguments.

2. Letter from Rainbow/Fallbrook

The letter from the Rainbow and Fallbrook General Managers is simply repeated complaints that they disagree with neutral LAFCO expert Dr. Hanemann, whom they voted to select. They do not like Dr. Hanemann's conclusions, so they claim he is in error. In fact, they continue to perpetrate false 'facts' about Dr. Hanemann's report, such as:

- They assert that, "Dr. Hanemann did not include the Infrastructure Access Charge of \$119/AF in the "all in" SDCWA rate or the Readiness-To-Serve charge and Capacity fees" This is incorrect. Table 3 of the Hanemann Report on page 34 includes the Infrastructure Access Charge. Further, the capacity fees are listed in the table. The Readiness-To-Serve charge is an MWD charge, not a Water Authority charge – it is simply passed through from MWD. It is also unclear why they allocate MWD's capacity charge across both CWA and MWD supply costs equally. Given the nature of the Water Authority's supply mix and contracted QSA delivery schedule (flat monthly deliveries), MWD supply is by definition the "peak."
- They assert that "[W]e operate our systems without the use of nearly all of the SDCWA system and yet have to pay for it." However, this is not correct. Indeed, as Dr. Hanemann noted, the actual facts are that Fallbrook and Rainbow significantly benefit from Water Authority membership: "FPUD's and RMWD's combined share of all fixed charges is 4.5% while their combined share of meter equivalents is 2.8% reflects the fact, on average, FPUD and RMWD customers use more water per meter equivalent than do customers of the other SDCWA member agencies." Report, p.106. Dr. Hanemann also noted that Rainbow and Fallbrook have directly benefited in the past: "The superior reliability of SDCWA's supply has benefitted FPUD and RMWD in the past. In the drought of 2009, SDCWA faced a 13% cut-back in the delivery of M-water. However, because of its access to QSA water, SDCWA was able to reduce deliveries to its member agencies by only 8%." Report, p.14.
- They assert that Dr. Hanemann said there was no meaningful difference between Water Authority reliability and what they would get via MWD through Eastern: "We agree with the ultimate conclusion reached by Dr. Hanemann regarding reliability: moving to EMWD will not have any significant impact on actual supply reliability" Again, this is false. In fact, Dr. Hanemann states there is a meaningful difference in reliability, over and over again. For example: Report, p.14: "The superior reliability of SDCWA's supply . . . "; Report, p.16: "FPUD and RMWD are taking something of a

gamble on supply reliability if they switch from SDCWA to EMWD”; Report, p.28: “Q. How is water supplied by MWD different from water supplied by SDCWA? A. It is different in source, it is different in supply reliability, and it is different in pricing.”; Report, p.83: “FPUD and MWD could face differences in the reliability of their water supply when served by EMWD versus SDCWA” and Report, p.84: “Q. Has the distinctive reliability of SDCWA’s supply portfolio actually made any difference? A. Yes. It would have made a difference if SDCWA had QSA water in the 1991 drought, it did make a difference that SDCWA had QSA water in the 2007-2009 drought, and it made a difference that SDCWA had desal water in the 2015-2016 drought.”

- They assert that MWD has the opportunity to acquire potentially more water in various ways if needed. This is completely off point, because they (again) ignore that both Eastern and the Water Authority are MWD members who can acquire MWD water, so any ability for MWD to acquire more water means the Water Authority’s reliability goes up along with Eastern’s. In fact, it increases even more than that of Eastern, because the Water Authority’s preferential rights at MWD are much higher than those of Eastern. Further, their claim belies the actual facts at MWD. Here is what former MWD General Manager Jeff Kightlinger said of MWD’s *inability* to acquire additional water in drought (emphases added):

“In the past, we’ve been able to reach out to the agricultural community and do spot-market transfers to move water around the state as needed. This time around, not only was there very limited water availability around the state, but we also faced restrictions on our ability to move water—for instance, restrictions in the Delta made it harder to move water from Northern to Southern California. As a result, the spot-market transfer essentially vanished. In essence, there was no water available to purchase in the state during this drought. That challenge has forced us to rethink how water markets can operate during severe droughts, particularly when endangered species restrictions and outdated infrastructure limit our flexibility.”¹

- They attack Dr. Hanemann for not including MWD’s conserved water agreements with IID and PVID, but in fact he did address both the PVID/MWD deal (Report, p.92) and the IID/MWD deal (Report, p.23). Again, Rainbow and Fallbrook just lob out attacks on Dr. Hanemann without the facts to support their assertions.
- They assert legal arguments pertaining to a possible “exit fee” that are not relevant to Dr. Hanemann’s non-legal work, and they ignore all the excruciatingly dispositive financial impacts on remaining member agencies of their sought exit already presented to LAFCO.
- They make the inflammatory and untrue remark that “... SDCWA could actually profit from a detachment process, in which it would be divested of the obligation to provide any services to the Districts.” This is false. SDCWA as a public agency does not make a “profit” and in any event, a departure fee would constitute Rainbow and Fallbrook’s fair share of obligations incurred while members of SDCWA.

¹ [Climate Change Impacts on California's Water Supply Require MWD to Prioritize Differently | VerdeXchange](#)

- They have provided a fundamentally flawed spreadsheet of costs, and improper attack on our agency's data. They double count IAC (adding an additional \$119/AF or 8.1% to the Water Authority's rate). They also mischaracterize MWD's Capacity Charge, significantly undervaluing a MWD supply cost. They also make no efforts to communicate the increase to RTS. Rainbow and Fallbrook benefit from lower RTS costs than they would should they detach. As the Water Authority has significant local supplies (QSA / Desal), no costs are incurred from RTS. Rainbow and Fallbrook would again incur MWD fixed higher costs to a rate (RTS) that is forecasted from \$140M in CY '22 to \$271M in CY '32 (7% CAGR for the decade).
- They assert that Dr. Hanemann is in error on how Water Authority members pay annually for water service. Not true. Dr. Hanemann's conclusion, that member agencies ultimately pay for the Water Authority costs, is similarly echoed by every rating agency. For example, Fitch Ratings in their January 2022 Ratings Review stated that the Water Authority's "board is able to fully reallocate costs and maintains independent rate raising ability."
- They improperly mingle the use of gross and net financials to underestimate impacts. They state that SDCWA has an annual budget of \$850M, so this [\$10M-\$12M impact] amounts to 1.2%-1.4% decrease." However, as demonstrated in Table ES3 of the Final Report, Dr. Hanemann shows a \$33M (gross) revenue impact. When appropriately compared to the Water Authority's operating budget, this represents a 4.7% decrease.

The simple truth is that Dr. Hanemann rightly concluded that detachment would be a "gamble" for Rainbow and Fallbrook and their ratepayers. (Report, p.16) This is because of at least the following detachment facts, which cannot be controverted, no matter how much Rainbow and Fallbrook try: (1) Rainbow and Fallbrook plan to move to MWD water, and would have no access to Eastern's other supplies (Report, p.84: "FPUD and RMWD would not have any access to EMWD's local supplies; they would be 100% reliant on M-water from MWD"); (2) MWD's water is less reliable than the Water Authority's because most of MWD's Colorado River supplies are lower in priority than those of the Water Authority that come via IID, and because of the Water Authority's desalinated water (Report, p.31: "IID's right to Colorado River water is senior to MWD's right to Colorado River water and is therefore more reliable"; and p.10: "Carlsbad Desal water is more reliable than E- or M-water because it is not derived from streamflow that is being affected by climate change"); and (3) as predicted by Dr. Hanemann, MWD's rates are rising faster than QSA water, closing any price gap between the agencies. (Report, p.61: "The recent trend has been for the average cost of M-water to SDCWA to grow faster than that of QSA water. That would tend to narrow the differential between SDCWA's all-in rate and MWD's all-in rate.")²

The sniping at Dr. Hanemann's report by Rainbow and Fallbrook is not supported by the facts, and Fallbrook and Rainbow cannot negate any of the above fundamentals. Detachment is indeed a gamble for Rainbow and Fallbrook's ratepayers. Management at Rainbow and Fallbrook not only want to put their own ratepayers at risk, they want the rest of San Diego County to bear the risks of lost voting power for San Diego County at MWD, increased costs for all remaining member agencies, and increased reliance on the Bay-Delta watershed.

² Indeed, MWD just announced it is considering a 9% rate increase for its water next year.

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We look forward to further addressing all these issues with the Committee and the Commission.
Thank you.

Sincerely,



Mark J. Hattam
General Counsel

cc via email:

Sandra L. Kerl, General Manager, SDCWA
Keene Simonds, Executive Officer, San Diego County LAFCO
Tom Kennedy, General Manager, Rainbow MWD
Jack Bebee, General Manager, Fallbrook PUD
Nick Kanetis, Deputy General Manager, Eastern MWD
Holly Whatley, Counsel, San Diego County LAFCO
Lloyd W. Pellman, Counsel, Rainbow MWD
Paula C. P. de Sousa, Counsel, Fallbrook PUD
Dr. Michael Hanemann
Water Authority Board of Directors